

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:)	
Application of Daufuskie Island Utility)	REPORT PURSUANT TO COMMISSION ORDER NO. 2020-496
Company, Incorporated for Approval of an)	
Increase for Water and Sewer Rates, Terms and)	
Conditions)	
_____)	

On July 22, 2020, the Public Service Commission of South Carolina (“Commission”) issued Order No. 2020-496 (the “Order”), in which the Commission requested that the South Carolina Office of Regulatory Staff (“ORS”) continue its investigatory review of Daufuskie Island Utility Company, Inc.’s (“DIUC”) rate case invoices and that ORS report its findings of its investigatory review of DIUC’s rate case invoices back to the Commission no later than 30 days from the receipt of the Order. Accordingly, ORS files this Report.

Introduction and Background

On June 29, 2020, ORS served on DIUC a first and continuing request for production of documents for the second remand proceeding. DIUC submitted a response on July 10, 2020, in which it unjustifiably alleged that ORS’s request for production of documents was in direct contradiction of a ruling of the South Carolina Supreme Court. DIUC filed its July 10, 2020, response with the Commission and the same is attached hereto as Report Exhibit 1. Subsequently, ORS filed a Motion for Clarification with the Commission seeking to determine whether the Commission sought to have ORS continue its investigatory review or cease to conduct any further review of DIUC and allow the Commission to make a ruling upon the record as it stood at the time.

On July 22, 2020, in response to the ORS Motion for Clarification, the Commission issued the Order requesting ORS to continue its investigatory review of DIUC. Accordingly, on July 23, 2020, counsel for ORS contacted counsel for DIUC via e-mail and “once again [reiterated] the [previously sent request] that all documentation that demonstrates payment of these invoices be provided.” Additionally, counsel stated ORS’s position that it “is imperative that the parties cooperatively work together to ensure all pertinent information is readily available.” On July 24, 2020, ORS issued a second continuing request for production of documents for the second remand proceeding. DIUC submitted a response on August 7, 2020, in which it again made the same unjustifiable accusations against ORS, despite the fact that ORS was seeking additional information at the direct request of the Commission. DIUC filed its August 7, 2020, response with the Commission and the same is attached hereto as Report Exhibit 2.

On August 17, 2020, ORS filed a Motion to Compel or, alternatively, to strike certain testimony of DIUC witness Mr. John Guastella. In support of the Motion to Compel, ORS outlined DIUC’s obligations, ORS’s regulatory duties and obligations to conduct relevant discovery, and DIUC’s continuing failure to cooperate with ORS’s discovery questions.

Findings

The ORS has substantial concerns about the sufficiency of the limited information provided by DIUC in response to the ORS first and second continuing request for production of documents for the second remand proceeding. DIUC’s responses do not rise to a level that ORS believes is responsive and for that reason, ORS filed a Motion to Compel on August 17, 2020. Subsequent to ORS filing its Motion to Compel, counsel for DIUC informed counsel for ORS that the additional \$269,356, which DIUC seeks to recover from its customers, is not a calculation of the

total dollar amount of specific DIUC invoices, but is simply the figure DIUC calculated that would push its rates up to the maximum dollar amount it noticed.

DIUC's refusal to cooperate with the investigation requested by the Commission notwithstanding, ORS also has concerns about the efficacy of the limited information DIUC has provided to date, and whether such limited responses can serve to justify imposing an additional \$269,356¹ in rate case expenses onto DIUC's customers. At the most basic level, DIUC has failed to provide basic accounting information that would allow ORS to tie these additional rate case expenses, for which it now seeks recovery, to any specific invoices. If this lack of basic accounting information were presented by another utility in another rate case, ORS would be compelled to recommend that these expenses not be authorized for recovery from the utility's customers. This failure presents serious concerns for a number of reasons. First, by failing to tie these additional rate case expenses to specific invoices, DIUC renders any audit that ORS would perform on these invoices meaningless. In other words, without tying documented support of any kind to the additional \$269,356 DIUC seeks to recover, the number DIUC now seeks is essentially un-auditable and has no evidentiary foundation. As the Commission is aware, Generally Accepted Auditing Standards, AU § 150, states "[t]he auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit."² This auditing standard is common sense, well established, and followed consistently in auditing an entity. Accordingly, while ORS may audit these invoices, absent a direct and traceable connection between the invoices and an expense sought, a valid invoice is only evidence of what the utility potentially *could* recover. The ongoing conduct of

¹ While DIUC has sought recovery of varying amounts in rate case expense since the initial proceeding, it now seeks an additional \$269,356.

² Generally Accepted Auditing Standards, AU § 150.03.

DIUC prevents ORS from providing the Commission with an evidence and accounting based recommendation addressing the contested rate case expenses now at issue.

Second, by failing to tie these additional rate case expenses for which DIUC seeks recovery to any specific invoices, DIUC is asking ORS and the Commission to arbitrarily pick a number for recovery that is based solely on the Company's maximum noticed rate. While ORS can agree that expenses have been incurred by DIUC in order to conduct these proceedings, and, for prudently incurred and properly documented costs, there should be recovery, ORS is unable to audit these additional rate case expenses sought by DIUC because it has failed to present basic accounting evidence that can be reviewed and examined. DIUC's current actions essentially require ORS to prove DIUC's case for it because, while DIUC may have a basis to recover *some* of these additional rate case expenses, it has not provided the required supporting evidence demonstrating it is entitled to recover *any* of these additional rate case expenses.

These problems are compounded by the fact that that Guastella Associate's ("GA") relationship with DIUC is not at arm's length. GA's Management Contract allows GA to be paid separately for its work related to the Application.³ Mr. Guastella is the president of GA and sits on the board of DIUC.⁴ Mr. Guastella previously testified that he both "tell[s] [Terry Lee]⁵ what to do" and that "[DIUC witness Guastella] report[s] to Mr. Lee."⁶ Mr. Guastella's testimony raises the clear specter that he sits on both sides of the negotiating table, thus further highlighting the substantial concerns about the GA expenses charged to DIUC.⁷ Most recently, in response to an ORS request asking that DIUC indicate the identity of the individual responsible for approval of

³ (Original Tr. p. 242, ll. 1-12; Original Hearing Exhibit 9; Order Nos. 2015-846 p. 24 and 2016-50 p. 11-13).

⁴ (Rehearing Tr. pp. 173, ll. 16-18, p. 192, l. 21). Terry Lee is president of DIUC, which utilizes GA. (Rehearing Tr. pp. 173, ll. 16-18)

⁵ Terry Lee is DIUC's President.

⁶ (Rehearing Tr. P. 205, l. 23, and Tr. P. 206, l. 10).

⁷ See Hilton Head Plantation Utils. v. Pub. Serv. Comm'n, 312 S.C. 448, 451, 441 S.E.2d 321, 323 (1994).

the rate case expenses for payment and the name of the individual responsible for processing the payment, DIUC stated, “John Guastella, President of GA, and Michal Guastella, Vice President of GA, are responsible for *approval and payment of all expenses* pursuant to the Management Agreement....”⁸ (emphasis added). It appears, therefore, that members of GA prepare the invoices to submit to DIUC and then write and approve the checks on behalf of DIUC, which then go to GA. While this unusual business conduct does not necessarily prohibit recovery, the increased economic risk assumed by management in allowing a lack of arm’s length transaction, necessitates that recovery of these expenses be examined with great care.

Additionally, the ORS review of GA invoices revealed an increase in the hourly bill rates on three different occasions, on 1/5/2015, 2/4/2016 and 7/17/2017, for various positions including the position titled “Principal 1.” The hourly bill rate increases did not exceed 4% at any point for any one position and these year over year increases are not necessarily unreasonable; however, it should be noted that John Guastella has unanimously raised hourly rates three times during the pendency of these proceedings and approves his firm's own bill rate increases.

Finally, by failing to tie these additional rate case expenses for which DIUC seeks recovery to specific invoices, DIUC has opened the door to a possible double recovery from its customers. DIUC has stated that it is owed at least \$542,978 in GA fees to be recovered as rate case expenses. However, as a result of the noticing requirements, DIUC is currently seeking only an additional \$269,356 in the present case. As a result, DIUC plans to seek at least the \$273,622 remaining in the subsequent rate case. Absent specific invoices directly tied to the specific dollar amount that DIUC is currently seeking, DIUC would have the ability to use any single invoice as justification for recovery both in this proceeding *and* the next. If specific invoices are not tied to the rate case

⁸ See Response to Question 2-1, Exhibit 2.

expenses that DIUC may recover in this case, there will be no way to ensure that DIUC does not double recover on any one invoice. In other words, because DIUC has not tied the additional \$269,356 in rate case expenses for which it seeks recovery from ratepayers to invoices, when the next rate case occurs and DIUC seeks the remaining \$273,622 there will be no way to determine whether invoices used to justify recovery of that remaining expense actually correspond to the currently sought rate case expenses of \$269,356.

DIUC's actions serve to improperly shift regulatory risk from itself onto its customers. By refusing to provide sufficient rate case expense and accounting documentation in this proceeding, and relying upon ORS to prove DIUC's case for it, DIUC seeks to shield itself from regulatory risk. For instance, if ORS were to recommend that DIUC be entitled to recover none of the additional \$269,356 in rate case expenses, DIUC may claim ORS is being unfairly punitive because DIUC performed at least some of the corresponding work. If, however, ORS were to recommend that DIUC recover some dollar amount between zero and \$269,356, DIUC may claim ORS has arbitrarily picked a number because DIUC itself failed to provide sufficient rate case expense documentation needed to warrant such a determination. Therefore, the only position to which DIUC may not object is a regulatory ruling that cannot be substantiated and the one that DIUC has placed before the Commission. In doing this, DIUC attempts to build an artificial regulatory shield to protect itself while passing the resultant costs onto its customers.

Conclusion

The regulatory process requires an examination of underlying utility data and information that a utility claims support its rate increase to determine if the actual utility books and records are in fact consistent with the representations made by utility witnesses in a proceeding. DIUC has failed to provide information responsive to the ORS requests and the limited information that

DIUC has provided creates serious evidentiary and legal obstacles regarding recoverability of the additional \$269,356 that DIUC now seeks from its ratepayers. ORS has concerns about the level of DIUC's cooperation, the substance of DIUC's limited responses, and the lack of arms-length generated expenses, which exceeds in total more than half a million dollars. Finally, perhaps most concerning is that ORS can find no evidence that Terry Lee, or someone other than GA, reviewed these expenses on behalf of DIUC and by extension its customers.

ORS will continue to conduct its regulatory examinations in a manner that is consistent with its statutory obligations in order to represent the public interest in this proceeding and will continue to comply with Commission Orders.

Respectfully submitted,

SOUTH CAROLINA OFFICE
OF REGULATORY STAFF

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